MANUFACTURERS HANOVER

Financial Digest

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Analysis of Business Trends Plus Selected Financial Indicators

Inflation Surges In Western Germany

Growing fears on the part of both the Bundesbank and Bonn government about rapidly increasing inflation in Germany were confirmed again with the announcement that consumer prices jumped by almost a full percent in July alone. This brought the year-over-year inflation rate to 4.4 percent, up sharply from 3½ percent in June and 2.4 percent in July 1990, and the most since the 4.6 percent year-over-year inflation rate recorded in December 1982 (see chart).

Although part of the increase in last month's inflation rate can be attributed to such items as higher fuel and income taxes and telephone charges that were implemented on July 1 to help pay for German unification, other factors are to blame as well. Throughout this year, Bundesbank officials have repeatedly expressed their concerns about Bonn's growing borrowing needs, hefty pay settlements in both western and eastern Germany and the mark's weakness against most of the other major currencies.

Last spring, for example, IG Metall, Germany's largest and most powerful labor union and the trendsetter for wage increases throughout the country, was granted a seven percent pay hike, well above the 2.8 percent inflation rate at the time. Other labor negotiations in western Germany are also being settled at around seven percent. As a result of rapidly rising wage increases, unit labor costs may well rise by about five percent this year, after increasing by two percent in 1990 and showing no growth in 1989 and 1988.

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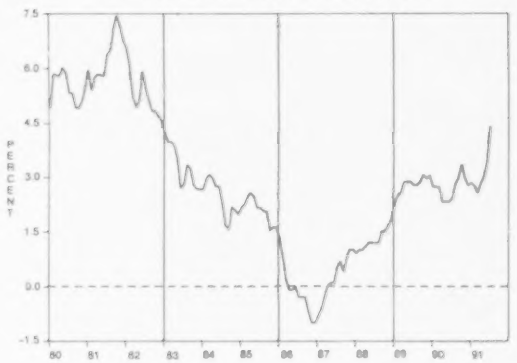
Price Pressures Plentiful

In addition to rapidly rising labor costs, Germany's expansionary fiscal policies have also added to price pressures this year. According to the Bundesbank's latest monthly bulletin, because of the higher-than-expected cost of rebuilding the five eastern states, Germany's public sector borrowing requirement is likely to rise to between 150 and 170 billion marks this year (equivalent to almost six percent of the German economy), up from around 93 billion marks in 1990. As recently as last November, the central bank had voiced its concerns that this year's public sector borrowing requirement would be as high as 140 billion marks.

12-MONTH PERCENT CHANGE
IN WESTERN GERMANY'S INFLATION RATE



Source: IMF

By raising the price of imports, the mark's weakness during most of this year has also contributed to inflation pressures in Germany. Undermined by political uncertainties in Eastern Europe and the Soviet Union, economic collapse in eastern Germany, the ballooning public sector deficit and Germany's sharply deteriorating trade performance, the mark had weakened to almost 1.84 marks per dollar last month, until the combination of several rounds of coordinated central bank intervention, disappointing news concerning the U.S. economic recovery and prospects of higher German interest rates prompted a seven percent appreciation of the German currency during the past few weeks.

Reflecting the huge investment needs to rebuild the eastern German economy and hefty demand for consumer goods, imports have surged this year, causing the country to record its first monthly trade deficits (in both April and May) since August 1981. Although June's trade balance returned to the black, the half-year trade surplus plunged to barely five billion marks from almost 67 billion marks in the first six months of 1990. What is more, after posting the largest current account surplus in the world last year, six straight months of red ink figures since January—to the tune of 20.1 billion marks—virtually ensure that Germany will record a current account deficit for the entire year, the first annual deficit since 1981. Although the trade

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balance is expected to remain in surplus this year, the country's trade performance is deteriorating so rapidly that a deficit for 1991 cannot be ruled out. If Germany does post a trade deficit this year, it will be the first yearly dose of red ink since 1952.

Higher Interest Rates Are Likely

With the inflation rate surging, the public sector deficit ballooning and the current account balance firmly in the red, it is highly probable that the Bundesbank will tighten its monetary policy in the not too distant future, possibly as soon as the next council meeting on August 15. Bundesbank President Helmut Schlesinger has already hinted at a rise in the discount rate at least, pointing out the unusually wide gap between the official discount rate, currently at 6½ percent, and the market-influenced Lombard rate, now at nine percent. The financial and foreign exchange markets are expecting a half-point hike in the discount rate, while a full percentage point increase in the discount rate and a half-point increase in the Lombard rate is possible.

For one thing, the Bundesbank has already made known the upper limits of its "comfort zone": An inflation rate of below four percent, a public sector borrowing requirement of 140

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (7/24/91)	188,978	- 251	- 25,259
New York City (7/31/91)	31,832	- 663	- 7,785
Commercial Paper (7/31/91)	541,130	+ 2,108	- 1,779

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (7/24/91)	302,573	- 1,529	- 17,057
New York City (7/31/91)	54,217	- 231	- 4,252

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (7/24/91)	1,020,035	- 3,804	+ 6,739
New York City (7/31/91)	171,467	+ 912	- 16,177

Financial Markets

	Friday 8/9/91	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	5.45%	- .16	- 2.30
180-Day Bills†	5.60	- .19	- 2.18
Longest Bills†	5.76	- .25	- 2.01
Recent Issues:			
6⅞s 7/31/93	6.44	- .23	
7⅞s 7/31/96	7.50	- .12	
7⅞s 8/15/01 (When Issued)	7.97	NA	
8⅛s 8/15/21 (When Issued)	8.22	NA	
Municipals:			
Bond Buyer—20 Bond Index* (8/8/91)	6.94%	- .05	- .21
Blue List Total ($ Million)	$ 980	- $ 373	- $ 134
30-Day Visible Supply ($ Million)	$3,946	- $1,431	+$2,630
Total	$4,926	- $1,804	+$2,496
Corporates:			
Moody's Aa Composite (8/8/91)	9.07%	- .12	- .39
30-Day Visible Supply ($ Million)	$1,480	+ $955	+$1,230
Stocks:			
Dow-Jones Averages:			
Industrials	2,996.20	- 10.06	+ 97.68
Transportation	1,213.68	- 9.52	+ 79.01
Utilities	203.18	+ .40	- .17
65 Stocks	1,069.11	- 4.33	+ 41.83
N.Y.S.E. Composite Index	212.17	+ .14	+ 18.85
N.Y.S.E. Avg. Daily Vol. for Week (000's)	155,855	- 4,707	- 16,115

*34% Taxable equivalent 10.52%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 8/9/91	Week Ago
Overnight	5.69%	5.75%
1 month	5.63	5.81
3 month	5.63	5.81
6 month	5.94	6.00
1 year	6.06	6.31

FOREIGN EXCHANGE SPOT RATES

New York Opening (8/9/91)	Currency Per U.S. $	Week Ago
Belgium	35.589	36.00
Canada	1.1473	1.1506
France	5.8785	5.9335
Germany	1.7290	1.7440
Italy	1293.00	1304.80
Japan	136.50	137.87
Mexico	3039.00	3036.20
Netherlands	1.9480	1.9675
South Korea	715.01	712.75
Switzerland	1.5148	1.5210
Taiwan	26.48	26.53
U.K.*	1.6940	1.6851

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (8/9/91) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	-0.4%	-10.3%

billion marks, and annual wage increases of under six percent. With all of these targets now widely overshot, it appears that the central bank will have to raise interest rates, if only to preserve its credibility. Indeed, it is widely believed that the Bundesbank didn't raise rates at its last council meeting only because it didn't want to embarrass the Bonn government before last month's G-7 summit meeting, with such countries as Great Britain and France so keen to lower theirs.

For another, because an increase in official German interest rates is already expected in the foreign exchange markets, a failure to tighten monetary policy may cause traders to question the Bundesbank's resolve and thus place substantial downward pressure on the mark. This, in turn, would only add to inflation pressures in Germany. And, finally, with wages soaring in both the western and eastern parts of the country, the central bank will want to give a warning to both labor unions and employers in order to set the right climate for Germany's next wage round. However, given the mark's vulnerability to Germany's economic problems and the political uncertainties in the Soviet Union and Eastern Europe, any boost to the German currency from a hike in the Bundesbank's key interest rates may be only temporary.

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 8/7/91	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	257.145	+ 1.668	+16.769
Loans to Depository Inst.	1.203	+ .622	+ .300
Float	.216	- .409	- .846
Total Reserve Bank Credit	293.804	+ 2.240	+12.222
Treasury Deposits with Federal Reserve Banks	5.808	- .663	+ .045
Currency in Circulation	293.365	+ 1.079	+23.792
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	243.747	- 1.412	+13.136
Member Bank Reserves:	8/7/91		
Total Reserves Held	50.261	- .168	- 8.60
Excess (Deficiency)	.830	- .106	+ .074
Net Free Reserves	.026	- .445	- .241

Monetary Aggregates †		‡ % Change Since 3 Months Ago*	% Change Since Year Ago
M1 (7/29/91)	864.4	+ 8.6	+ 6.3
M2 (7/29/91)	3,385.1	+ 0.2	+ 3.2
M3 (7/29/91)	4,145.9	- 2.6	+ 1.9
Domestic Nonfinancial Debt (1st Q'91)	10,634.2	+ 2.8	+ 5.5

† Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 8/9/91	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	5.34%	5.38%	5.46%
* Federal Agencies	5.96	6.40	6.40
* Municipal Notes–High Grade (34% Taxable Equivalent)	6.44	6.82	7.12
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	5.65	5.82	5.95

‡ Finance Company Paper–Prime

5- 14 days	5.50%
15- 29 days	5.50
30- 59 days	5.55
60- 89 days	5.55
90-179 days	5.49
180-239 days	5.57
240-270 days	5.57

‡* Bankers' Acceptances

Sep.	5.53%
Oct.	5.53
Nov.	5.53
Dec.	5.54
Jan.	5.55
Feb.	5.53

‡ Industrial Paper–Prime

30- 89 days	5.64%
90-120 days	5.60

†Federal Funds Effective Rate 5.25%

‡ Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'91	$ 5,620	$ 5,558	$ 5,443
Gross National Product (1982 Dollars)*	2nd Q'91	$ 4,128	$ 4,124	$ 4,155
Percent Change, Annual Rate	2nd Q'91	+ 0.4	- 2.8	+ 0.4
Change in Consumer Prices*	Jun '91	2.4%	3.6%	7.2%
Change in MH Cost of Living Index*	Jun '91	6.0%	2.4%	7.2%
Change in Producer Prices*	Jul '91 n	- 2.4%	- 3.6%	+ 3.6%
Civilian Employment (Thousands of Persons) †	Jul '91 n	116,712	116,884	117,882
Unemployment as % of Civilian Labor Force †	Jul '91 n	6.8%	7.0%	5.5%
Personal Income*	Jun '91 n	$ 4,803	$ 4,780r	$ 4,641
Leading Indicators Composite Index (1967=100) †	Jun '91 n	143.6	142.9r	146.2
Industrial Production Index (1977=100) †	Jun '91	106.9	106.2	110.1
Net Change in Consumer Installment Credit †	Jun '91 n	- $ 1.83	- $ 1.33r	+$ 0.77
U.S. Merchandise Trade Balance †	May '91	- $ 4.57	- $ 4.51	- $ 8.15
Plant and Equipment Expenditures*	3rd Q'91	$ 553.5(a)	$ 544.2(a)	$ 534.9
Private Housing Starts (Thousands of Units)*	Jun '91	1,040	989	1,187
New Construction Expenditures*	Jun '91 n	$ 400.3	$ 399.2r	$ 450.4
Total Business Inventories †	May '91	$ 812.5	$ 816.9	$ 816.7
Total Business Sales †	May '91	$ 536.4	$ 530.9	$ 540.4

*Seasonally adjusted annual rate. † Seasonally adjusted. n-Newly reported figure r-Revised. a-Anticipated.

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